



Tennessee Valley Authority

Managing Today, Preparing for Tomorrow

2006 Rate Review

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Forward-Looking Statements

This presentation contains forward-looking statements relating to future events and future performance. Any statements regarding expectations, beliefs, plans, projections, estimates, objectives, intentions, assumptions or otherwise relating to future events or performance may be forward-looking.

In certain cases, forward-looking statements can be identified by the use of the words such as “may,” “will,” “should,” “expect,” “anticipate,” “believe,” “intend,” “project,” “plan,” “predict,” “assume,” “estimate,” “objective,” “possible,” “potential,” or other similar expressions.

Some examples of forward-looking statements include statements regarding TVA’s projections of future power and energy requirements; future costs related to environmental compliance; impacts of potential legislation on TVA and the likelihood of enactment of such legislation; strategic objectives; anticipated availability of nuclear waste storage facilities; projections of nuclear decommissioning costs; and impacts of pending litigation and various administrative orders which have been or may be issued.

Although TVA believes that the assumptions underlying the forward-looking statements are reasonable, TVA does not guarantee the accuracy of these statements. Numerous factors could cause actual results to differ materially from those in the forward-looking statements. These factors include, among other things, new laws, regulations, and administrative orders, especially those related to the restructuring of the electric power industry and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial and economic environment; performance of TVA’s generation and transmission assets; fuel prices; demand for electricity; changes in technology; changes in the price of power; loss of any significant customers or suppliers; creditworthiness of counterparties; weather conditions and other natural phenomena; changes in accounting standards; and unforeseeable events. New factors emerge from time to time, and it is not possible for management to predict all such factors or to assess the extent to which any factor or combination of factors may impact TVA’s business or cause results to differ materially from those contained in any forward-looking statement.

TVA undertakes no obligation to update any forward-looking statement to reflect developments that occur after the statement is made.



TVA Financial Review

Presentation Outline

- Financials and Cost Trends
- Financial Challenges
- Cost Mitigation Measures
- Ratemaking Approach
- FY 2006 Proposed Budget
- Conclusion & Recommendation
 - *Rate Adjustment*
 - *FY 2006 Budget Proposal*



Income Statement Forecast

(without adjustment)

(Millions of Dollars)

	<u>2004 Actual</u>	<u>2005 Expected</u>	<u>2006 Forecast</u>	<u>2007 Forecast</u>
Revenue	\$ 7,520	\$ 7,798	\$8,191	\$8,446
Operating Expenses				
Fuel & Purchased Power	(2,094)	(2,453)	(2,856)	(2,995)
Operating, Maintenance & Other	(2,328)	(2,447)	(2,426)	(2,451)
Depreciation & Amortization	(1,119)	(1,132)	(1,591)	(1,665)
Tax Equivalents	<u>(338)</u>	<u>(365)</u>	<u>(375)</u>	<u>(396)</u>
Total Operating Expenses	<u>(5,879)</u>	<u>(6,397)</u>	<u>(7,248)</u>	<u>(7,507)</u>
Operating Income	1,641	1,401	943	939
Other Income	61	44	34	29
Interest Expense (net)	<u>(1,305)</u>	<u>(1,282)</u>	<u>(1,288)</u>	<u>(1,314)</u>
Net Income	<u>\$ 397</u>	<u>\$ 163</u>	<u>\$ (311)</u>	<u>\$ (346)</u>



Cash Flow Forecast (without adjustment)

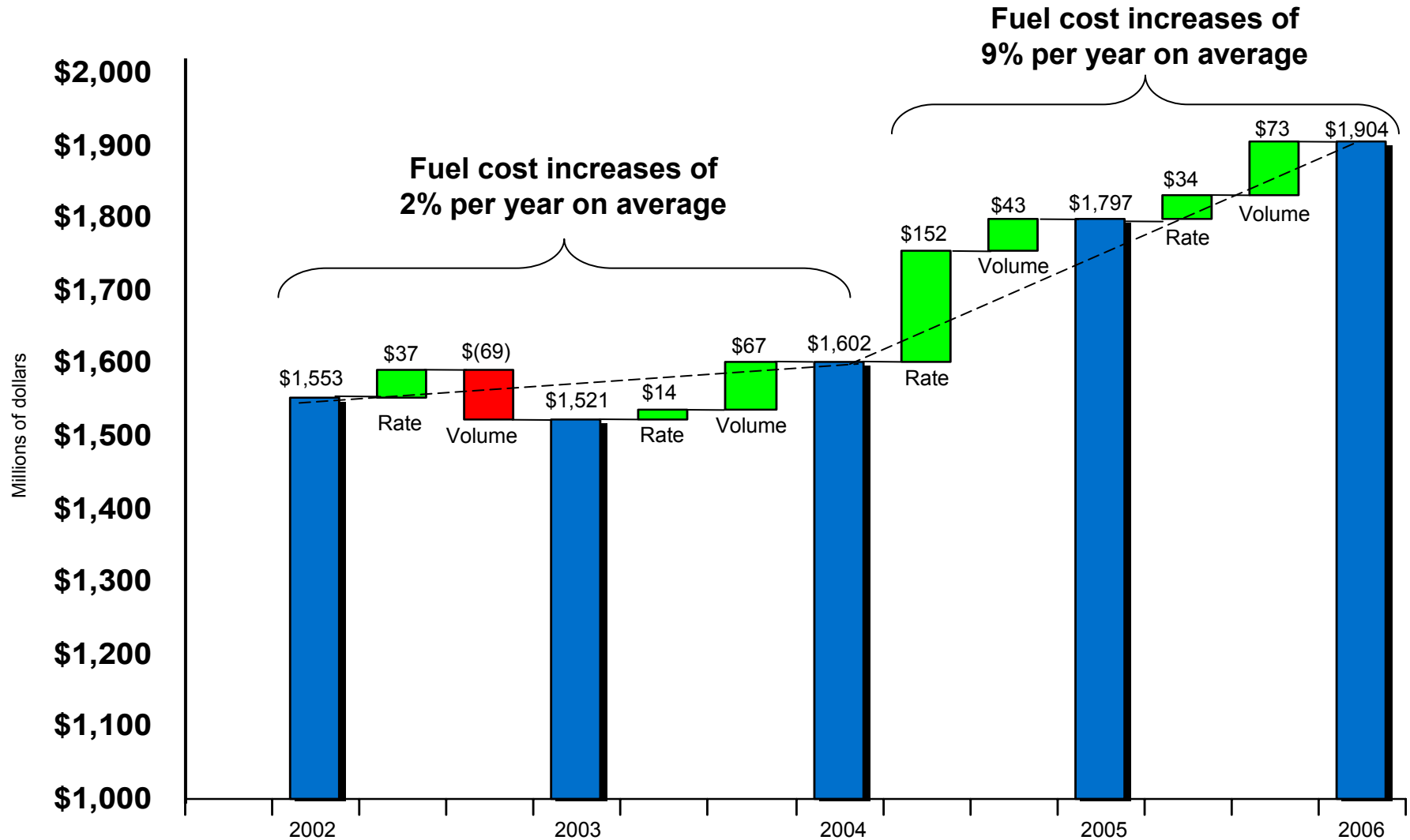
(Millions of Dollars)	2004 <u>Actual</u>	2005 <u>Expected</u>	2006 <u>Forecast</u>	2007 <u>Forecast</u>
Sources:				
Cash from Operations*	\$ 1,785	\$ 1,566	\$ 1,443	\$ 1,303
Proceeds from Fin. Oblig. A	1,504	—	—	—
Total Sources	<u>\$ 3,289</u>	<u>\$ 1,566</u>	<u>\$ 1,443</u>	<u>\$ 1,303</u>
Uses:				
Capital Projects	\$ (1,055)	\$ (1,118)	\$ (1,132)	\$ (784)
Clean Air Projects	(411)	(255)	(201)	(305)
Nuclear Fuel	(119)	(152)	(248)	(226)
Other Sources/(Uses)	103	34	(13)	(24)
Payments to U.S. Treasury	(38)	(36)	(38)	(38)
Change in Total Fin. Oblig. B	(1,782)	(280)	75	74
Total Uses	<u>\$ (3,302)</u>	<u>\$ (1,807)</u>	<u>\$ (1,557)</u>	<u>\$ (1,303)</u>
Change in Cash	<u>\$ (13)</u>	<u>\$ (241)</u>	<u>\$ (114)</u>	<u>\$ —</u>
Net Change in Fin. Oblig A+B	<u>\$ (278)</u>	<u>\$ (280)</u>	<u>\$ 75</u>	<u>\$ 74</u>

*Excludes proceeds from energy prepayments which are included in "Proceeds from Financing Obligations."



Trend in Fuel Expense

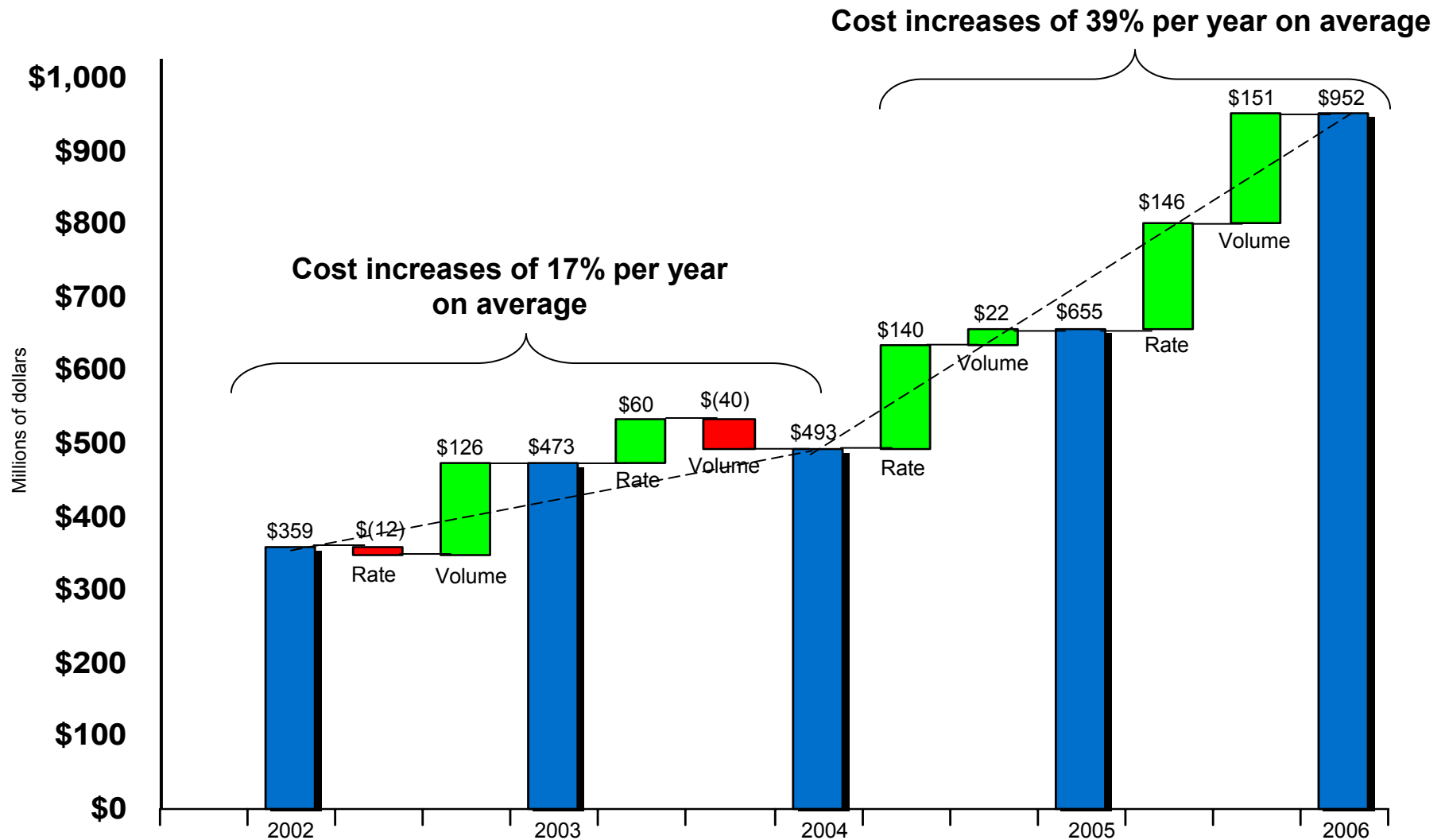
Significant Fuel Cost Increases Beginning in FY 2004





Trend in Purchased Power Expense

Significant Purchased Power Cost Increases Beginning in FY 2004



Summary of Financial Challenges

- Fuel and purchased power prices have risen significantly through FY 2006
- As TVA's load continues to grow, TVA must purchase the needed power from other suppliers
- TVA continues to focus on reducing total financing obligations to improve financial health and flexibility in the future
- Clean Air expenditures remain significant
- TVA must continue to invest in the power system to ensure the safe, efficient, and reliable generation and transmission of power

We are committed to reduce controllable costs to mitigate the increases in non-discretionary fuel and purchased power costs.

Recent Cost Mitigation Measures

- Reduce Labor Costs – 728 voluntary and involuntary reductions resulting in over \$51 million in total annual compensation savings
- Benefit Program Changes – Changes in FY 2005 resulted in \$15 million annual cost avoidance
- Consolidation of Organizations
- Standardization of Procedures
- Hydro Modernization & Automation
- Multi-skilling – Implementation of multi-skill training resulted in \$5.7 million reduction in annual labor cost (to date)
- Facilities Strategic Plan – Savings of \$25 million
- Inventory Optimization Strategies – \$39 million
- Debt Refinancing – Savings in FY 2005 of \$28 million and FY 2006 of \$71 million
- Project review and optimization to improve cash utilization

2006 Cost Mitigation Measures

- Base O&M reduced \$30 million
- Outage Expense reduced \$9 million
- O&M Projects reduced \$12 million
- Allowance Inventory Purchases reduced \$9 million
- Capital Expenditures reduced \$27 million
- Nuclear Fuel Enrichment & Fabrication reduced \$10 million as a result of price negotiations
- Total reductions of \$97 million

We still have more work to be done and are committed to continuing to find savings.

Ratemaking Approach

Most public power entities use the debt service approach to provide sufficient cash to operate the business and maintain credit worthiness:

- Fuel and Purchased Power Expense
- Operations and Maintenance Expense
- Payments in Lieu of Taxes
- Cash for Investment in Facilities
- Cash for Debt Service

Ratemaking Calculation

		2004	2005	2006
	Fuel and Purchased Power	2,094	2,453	2,856
	O&M, Net of Non Cash Items	2,081	2,116	2,158
	Taxes	338	365	375
1	Total Cash Operating Expenses	4,513	4,934	5,389
	Investing and Debt Service			
	Interest Expense	1,379	1,371	1,376
	Statutory Debt Reduction*	187	140	200
	Reduction in Other Financing Obligations*	153	140	140
	Capital and Other Cash:			
	Capital Investment	1,466	1,384	1,334
	Nuclear Fuel Fabrication	77	78	75
	Other Cash Requirements (Sources)	54	91	201
	Subtotal Capital and Other Cash	1,597	1,553	1,610
2	Total Financing and Investment	3,316	3,204	3,326
1 + 2	Projected Revenue from Rates	7,829	8,138	8,715
	Forecasted Revenue	7,520	7,798	8,191
	Revenue Deficit / Surplus	(309)	(340)	(524)

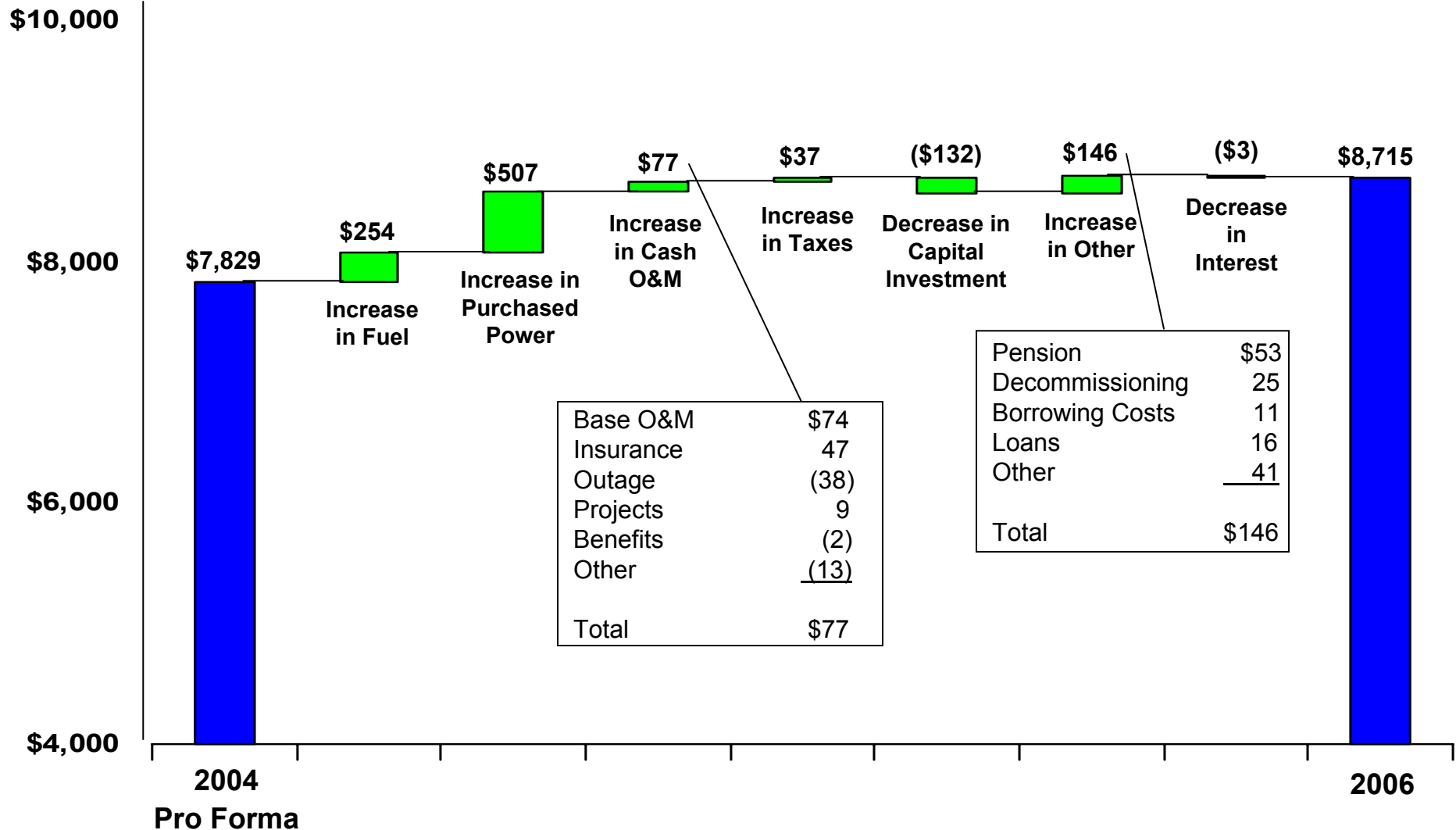
*Pro Forma for \$340 million TFO reduction in 2004



Changes in Revenues

FY2004 to FY2006

(in millions)





FY 2006

Budgeted Income Statement

(with Rate Adjustment)

(Millions of Dollars)	2004 Actual	2005 Expected	2006 Pro Forma	2007 Forecast
Revenue	\$ 7,520	\$ 7,798	\$ 8,715	\$ 8,981
Operating Expenses				
Fuel & Purchased Power	(2,094)	(2,453)	(2,856)	(2,995)
Operating, Maintenance & Other	(2,328)	(2,447)	(2,426)	(2,451)
Depreciation & Amortization	(1,119)	(1,132)	(1,591)	(1,665)
Tax Equivalents	(338)	(365)	(375)	(422)
Total Operating Expenses	(5,879)	(6,397)	(7,248)	(7,533)
Operating Income	1,641	1,401	1,467	1,448
Other Income	61	44	34	29
Interest Expense (net)	(1,305)	(1,282)	(1,288)	(1,314)
Net Income	\$ 397	\$ 163	\$ 213	\$ 163

FY 2006

Budgeted Cash Flow Statement (with Rate Adjustment)

(Millions of Dollars)	<u>2004 Actual</u>	<u>2005 Expected</u>	<u>2006 Pro Forma</u>	<u>2007 Forecast</u>
Sources:				
Cash from Operations*	\$ 1,785	\$ 1,566	\$ 1,972	\$ 1,812
Proceeds from Fin. Oblig. A	1,504	—	—	—
Total Sources	<u><u>\$ 3,289</u></u>	<u><u>\$ 1,566</u></u>	<u><u>\$ 1,972</u></u>	<u><u>\$ 1,812</u></u>
Uses:				
Capital Projects	\$ (1,055)	\$(1,118)	\$(1,132)	\$ (784)
Clean Air Projects	(411)	(255)	(201)	(305)
Nuclear Fuel	(119)	(152)	(248)	(226)
Other Sources/(Uses)	103	34	(13)	(24)
Payments to U.S. Treasury	(38)	(36)	(38)	(38)
Reduction in Total Fin. Oblig. B	(1,782)	(280)	(340)	(435)
Total Uses	<u><u>\$ (3,302)</u></u>	<u><u>\$ (1,807)</u></u>	<u><u>\$ (1,972)</u></u>	<u><u>\$ (1,812)</u></u>
Change in Cash	<u><u>\$ (13)</u></u>	<u><u>\$ (241)</u></u>	<u><u>\$ —</u></u>	<u><u>\$ —</u></u>
Net Change in Fin. Oblig A+B	<u><u>\$ (278)</u></u>	<u><u>\$ (280)</u></u>	<u><u>\$ (340)</u></u>	<u><u>\$ (435)</u></u>

*Excludes proceeds from energy prepayments which are included in "Proceeds from Financing Obligations."

Conclusion and Recommendation

Conclusion:

- TVA can no longer absorb in existing base rates the increases in non-discretionary costs and achieve its strategic plan objectives without sharing a portion of the financial burden with its customers

Recommendation:

- TVA staff proposes to increase revenues sufficient to collect an additional estimated \$524 million by raising firm wholesale power rates